FILE COPY

JUL 16

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1932.

No. 104.

BANKERS POCAHONTAS COAL COMPANY,
PETITIONER,

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE.

No. 105.

D. J. F. STROTHER, PETITIONER,

v.

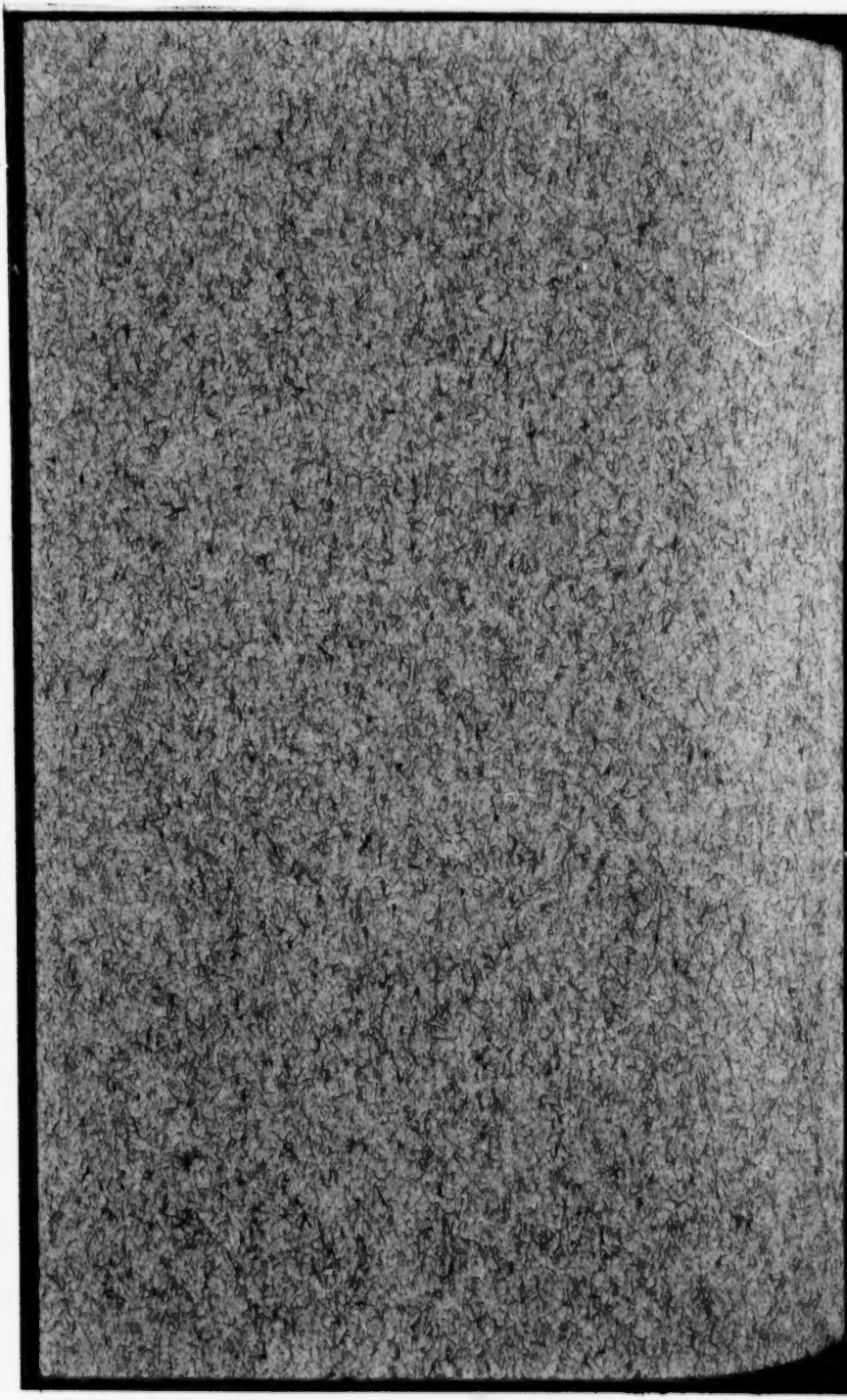
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

RESPONSE OF PETITIONERS TO OPPOSITION BRIEF OF RESPONDENT.

WELLS GOODYKOONTZ,
CAMDEN R. McATEE,
Attorneys for Petitioners.

MASON, SPALDING & McATEE,
GOODYKOONTZ AND SLAVEN,
Of Counsel.



INDEX.

Subject Index.

	Page
Introduction	1
Granted certioraris not distinguishable	2
No sufficient opposition	2
The facts	2
The issues—*Basically*, a constitutional and statutory issue	3
Alternatively, the basis of depletion and *res adjudicata*	3
Argument—*Basically:*	
Error in holding sale proceeds to be taxable lease royalties	4
Same not taxable	4
State rule of property controls	4
Conflict of decisions	4
Respondent does not justify lower court	5
Citations not in point	5
No lease nor royalties in present case	6
Constitutional conflict	7
Harmel decision applicable	8
Argument—*Alternatively:*	
Minimum payments are cash bonuses	10
Murphy Oil decision applicable	10
Res adjudicata unanswered	11
Conclusion	11

Citations.

Burnet v. Logan, 283 U. S. 404	4
Burnet v. Thompson Oil & Gas Co., 283 U. S. 301	5
Crile v. Commissioner, 55 F. (2) 804 (C. C. A. 6)	7
Crooks v. Harrelson, 283 U. S. 56	6
Darby Linde Co. v. Commissioner, 51 F. (2) 32 (C. C. A. 10) cert. denied	5
Ferguson v. Commissioner, 45 F. (2) 573 (C. C. A. 5)	6, 9
Group No. 1 Oil Corp. v. Bass, 283 U. S. 279	4, 5, 6, 7, 8
Harmel v. Commissioner, 52 F. (2) 153 (Burnet v. Harmel No. 26, on certiorari)	2, 3, 5, 6, 9
Hirschi v. United States, 67 Ct. Cl. 637	6

Page

Jefferson Gas Coal Co. v. Commissioner, 52 F. (2) 120..... 4, 6, 7
McLean v. United States, 226 U. S. 374..... 7
Murphy Oil Co. v. Burnet, 55 F. (2) 17 (No. 80, on certiorari) 2, 3, 10
Pugh v. Commissioner, 51 F. (2) 32 (C. C. A. 10) (cert. denied) 5
Saunders v. Commissioner, 29 F. (2) 832..... 4
Schneider v. Duffy, 43 F. (2) 642..... 4
South Vernon Oil Co. v. Hopkins, 49 F. (2) 1628 (C. C. A. 5).. 5
Stanton v. Baltic M. Co., 240 U. S. 103..... 5
Steedman v. United States, 63 Ct. Cl. 226..... 6
Stratton's Independence v. Howbert, 231 U. S. 209..... 4, 5, 7
United States v. Guinzberg, 293 F. 129..... 4
Von Baumbach v. Sargent Land Co., 242 U. S. 503..... 5

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1932.

No. 104.

BANKERS POCAHONTAS COAL COMPANY,
PETITIONER,
v.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE.

No. 105.

D. J. F. STROTHER, PETITIONER,
v.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

RESPONSE OF PETITIONERS TO OPPOSITION BRIEF OF RESPONDENT.

Supplementing their petition for certiorari, and responsive to the opposition brief of respondent, peti-

tioners suggest that certiorari has been granted in two of the decisions relied upon by petitioners, which are not distinguishable from the present case as contended by respondent, and that respondent shows no substantial reason for opposing grants of certiorari herein.

The writs have been granted in *Harmel* v. *Commissioner*, 56 F. (2d) 153, on April 18, 1932 (now pending as *Burnet* v. *Harmel, No.* 26, *October Term,* 1932), and in *Murphy Oil Co.* v. *Burnet*, 55 F. (2d) 17, on May 31, 1932 (now pending as *No.* 80, *October Term,* 1932).

The application of the same principles to these cases and to the *Harmel* and *Murphy* cases would doubtless have changed the result in one of the two sets of cases, notwithstanding any due allowance for differences in facts.

Under such circumstances, grant of certiorari herein is submitted to be just and proper.

Summary of Facts.

The tax-liability of petitioner Strother rises or falls with that of petitioner Coal Company, as its stockholder, and need not be discussed in detail.

Briefly, the predecessors of petitioner Coal Company as owners in fee of West Virginia acreage, valueless except for its coal content, sold said coal content in place, in 1901 and 1902, to certain operators for a consideration of "ten cents for each and every ton of coal mined" and "$5,000 for each and every year as a minimum" (Petition, p. 15), and retained no interest in said coal content. In 1912, petitioner Coal Company was organized, and acquired the fee to said acreage

subject to said contracts, and the beneficial interest of its predecessors to collect and receive said contract considerations in the subsequent years, and, having no other business, has so collected them, and distributed them, upon a cash basis, to its stockholders. Thus, neither its predecessors nor petitioner Coal Company were ever in the mining business, and have only collected the deferred proceeds of a sale of real estate as effected and completed in 1902.

The Issues.

Petitioner Coal Company therefore submits said sale receipts (*Harmel case, supra*), are not ordinary income subject to income tax, but are mere naked receipts of a claim existing unconditionally on and before March 1, 1913, and thereafter collected, which Congress cannot subject to income taxes. Alternatively, if said receipts be taxable as royalties subject to depletion allowances, petitioner Coal Company submits the cash bonuses derived from minimum royalties (*Murphy Oil case, supra*) are depletable, and the rate of depletion is *res adjudicata* from prior litigation.

ARGUMENT.

Said proceeds of sale are not taxable lease-royalties as held by the lower court.

The Circuit Court of Appeals held the 1902 contracts constituted a sale of the mineral in place under the law of West Virginia (R., p. 123). It only remained (upon

authority of *Stratton's Independence* v. *Howbert,* 231 U. S. 399; *Saunders* v. *Commissioner,* 29 F. (2) 832 (C. C. A., 3); *United States* v. *Guinzberg,* 278 F. 363 (C. C. A., 2); *Park* v. *Gillican,* 293 F. 129; *Schneider* v. *Duffy,* 43 F. (2) 642 (Cf. Petitioners' Brief, pp. 16, 17); (*Burnet* v. *Logan,* 283 U. S. 404) (Cf. Petitioners' Brief, p. 20)) for the Court to say the sale proceeds received in the later years were not taxable because they were the subsequent collections of a claim existing at and before the enactment of the XVIth Amendment.

But the Court erroneously said Congress intended to and does tax said receipts as royalties of a lessor subject to the statutory depletion deductions (R., p. 124), thus raising the primary constitutional and statutory questions. As mere sale proceeds established before the amendment and subsequently received as a return of capital, they were not taxable, and as the proceeds of a severance of interest, which is not the realization of capital and income from any retained interest in the property, they are not the royalties of a lessor. If the lower court is not in error, then a vendor or vendee (under the State law), in West Virginia, Pennsylvania and Texas of mineral in place is a lessor or lessee (under the Federal Revenue Acts), in Washington, D. C., and entitled there to the privileges of a lessor or lessee, viz., to any immunity of the lessor from tax, which is denied in *Group No.* 1 *Oil Corp.* v. *Bass,* 283 U. S. 279, to deductions of capital payments as rentals paid by a lessee which is denied in *Jefferson Gas Coal Co.* v. *Commissioner,* 52 F. (2) 120 (C. C. A.,

3), to treat a sale in place as a retained interest, which is denied in *Group One Oil Corp.* v. *Bass* (*supra*), and *Harmel* v. *Commissioner* (*supra*). If the lower court is not in error, then these decisions are wrong, as well as those cited above to establish that the proceeds of this particular sale in place are not taxable. If the lower court is not in error, the statutory allowance of depletion, only to the owner of a mineral property or equitably to the lessor and lessee of same upon their apparent interests in said property, is meaningless, which is denied in *Stanton* v. *Baltic M. Co.*, 240 U. S. 103, and *Burnet* v. *Thompson Oil and Gas Co.*, 283 U. S. 301, wherein depletion is declared not a matter of right and to be only authorized by the Revenue Acts; if the lower court is not so in error, a sale does not sever the depletable interest and deprive the vendor thereof, which is denied in *Darby Linde Co.* v. *Commissioner*, 51 F. (2) 32 (C. C. A., 10) (Cert. denied, 52 S. C. 40), in *Pugh* v. *Commissioner*, 49 F. (2) 76 (C. C. A., 5) (Cert. denied, 52 S. C. 22); *South Vernon Oil Co.* v. *Hopkins*, 49 F. (2) 1028 (C. C. A., 5), and *Group No. One Oil Corp.* v. *Bass*, 283 U. S. 279.

Respondent does not justify the ruling of the lower court.

Respondent in opposition (p. 9) says the authority and intention of Congress to tax the sales proceeds is upheld in *Stanton* v. *Baltic M. Co.*, 240 U. S. 103; *Stratton's Independence* v. *Howbert; Von Baumbach* v. *Sargent Land Co.*, and other decisions cited by the lower court (R., p. 123), in that they decide *royalties received*

under leases are income. But only two of these decisions affect instruments constituting a sale of mineral in place under the law of the State where same was situate. These are the *Hirschi* case from Texas, which is now contradicted by *Ferguson* v. *Commissioner,* 45 F. (2) 573 (C. C. A., 5), by *Group No. One Oil Corp.* v. *Bass* (*supra*), which respondent accepts, and by *Harmel* v. *Commissioner* (*supra*), in which respondent has obtained certiorari; and the *Roseberger* case from Pennsylvania, which has been broken down by *Jefferson Gas Coal Co.* v. *Commissioner,* 52 F. (2) 120 (C. C. A., 3). The *Steedman* case (Cert. denied, 275 U. S. 528) relied upon in the *Hirschi* decision is expressly disapproved in *Crooks* v. *Harrelson,* 282 U. S. 56, 63 (Cf. Petitioners' Brief, pp. 23-25), and *Ferguson* v. *Commissioner,* expressly and effectively distinguishes the *Stanton* decision by use of the same quotation (Opposition, p. 9) exhibited by respondent. Herein, the respondent's proposition, *royalties received under leases are income,* is without application, for there are *no leases,* and on the contrary *a sale in* 1902, and there are no royalties, for as said in the *Ferguson* opinion:

> —"royalties represent the retained interest of the lessor or the vendor in the property or minerals which he receives from time to time as revenues under the contract. He (Ferguson) did not convey that interest under the deed or lease, but provided that he should receive a fraction of the minerals themselves as produced * * *."

Consequently, the instant outright payment by the operators of 10 cents per ton of coal mined is not a royalty, but is a capital payment as said in *Burnet* v. *Logan* (*supra*), and *Jefferson Gas Coal Co.* v. *Commissioner* (*supra*) (Cf. Petitioners' Brief, pp. 19, 20).

That a sale in place effects a severance of the interest of the vendor is the State rule of property upheld in income tax cases from Texas (*Group No. One Oil Corp.* v. *Bass*), from Pennsylvania (*Jefferson Gas Coal Co.* v. *Commissioner*), and it remains to correct the erroneous conclusion of the lower court that, notwithstanding such serverance, the vendor and assigns retain a depletable interest in the property sold. It being true, as often decided by this Court, that the Revenue Acts are subject to State rules of property (Cf. Petitioners' Brief, pp. 24, 25) in ascertaining the ownership of property and defining income therefrom, it is evident error for the lower court to say the Revenue Acts require State rules of property to be ignored; for, as said in *McLean* v. *United States,* 226 U. S. 374, 382:

> "To decide otherwise is to say that Congress gave a right and took it away in the same instant."

Having here a completed sale of the property (Cf. *Strattons Independence* v. *Howbert* and *Crile* v. *Commissioner,* Petitioners' Brief, pp. 17, 18), with no retained interest and no income resulting from any use of the property, which sale was effected before the amendment, the decision of the lower court that sale-proceeds thereafter received are lease royalties subject to income tax conflicts with previous decisions of this

Court and denies the constitutional rights of petitioner.

Respondent errs in attempting to distinguish the Harmel case, in which certiorari has been granted.

The present case is identical with the *Ferguson* and *Harmel* cases when read in connection with *Group No. One Oil Corp.* v. *Bass,* 283 U. S. 279, decided in the interval between them. Herein, all coal in place was demised for a consideration of "10 cents for each ton mined"; *Ferguson,* in Texas, leased his property for oil production for a consideration of "the equal one-eighth of all oil produced and saved", and a cash consideration (20 B. T. A. 130); *Harmel,* in Texas, leased his property for "stipulated royalties and a cash consideration (19 B. T. A. 376); *Group One,* in Texas, leased State property for "the value of one-eighth of the petroleum produced" (*supra*). The *Group One* decision by this Court, in deciding the sale in place divested the property of its previous ownership and incident tax immunity, adopts the Texas law that:

> "They (the leases) do not authorize the purchaser to take and use 7/8ths or any other mere fractional part of the oil or gas in the land leased. The purchaser instead buys all the oil and gas, for a stipulated price, part of the price being measured by the value of a certain fraction of the produced oil and gas, which is a very different thing from the value of that fraction of the oil and gas in place. *The leases conveyed all the oil and gas* in granting the right to find, produce, and appropriate all of them, *in consider-*

ation of the payment of stipulated sums and also the value of a stated fraction of the oil and gas produced.'' (Italics supplied.)

It seems clear the *Ferguson* and *Group One* contracts are within this rule, and reference to the *Harmel* record also shows the "equal one-eighth" as in the *Ferguson* case. It follows that in each case the consideration was, as stated by this Court, "stipulated sums and also the value of a stated fraction of the oil and gas produced" (*supra*). This means a deferred payment as in the present case, payable on production of the mineral, and that the cases are identical. In the *Ferguson* and *Harmel* cases this was not recognized or claimed by taxpayers, and the court was led to conclude the one-eighth was a retained interest subject to depletion. This attitude, error though it may be, does not distinguish the *Ferguson* or *Harmel* cases from the present case, for herein, as in the *Group One* case, there is no retained interest. Respondent argues it exists, because in the *Ferguson* and *Harmel* cases a retained interest is recognized to exist, and because herein there are deferred payments. But *Group One* rests upon a consideration deferred in its entirety, and, being a sale in place, the deferment of the consideration does not militate against the severance of interest thereby consummated in the execution and delivery of the instrument of sale.

The alternative position of petitioners.

The primary position of petitioner Coal Company is that the sale proceeds of the contract consummated

before the amendment are not taxable when thereafter received. If they are taxable as royalties subject to depletion, the alternative questions of the sufficiency of depletion allowances are presented. The Board and lower court refused to allow depletion upon bonus payments, being the excess of the annual minimum payments over coal actually mined, whereby depletion is denied upon over 2,000,000 tons of coal paid for but not mined in the years in controversy (Cf. Record, pp. 160, 161), and refused to allow depletion at the rate previously adjudged in litigation between the parties.

Respondent errs in attempting to distinguish the Murphy Oil case, in which certiorari has been granted.

Respondent (Opposition, p. 15) entirely misconceived any alleged conflict of the present case with the *Murphy Oil Company* case, wherein the Circuit Court of Appeals held a cash bonus was subject to depletion allowances and reversed the Board rulings which the Court of Appeals herein has sustained. Petitioner Coal Company here received the minimum annual payment as a cash bonus to the extent that the operator could not mine coal equal to such payment, and upon this ground, affirmed by the lower court (R., p. 132), that such excess cash payment is a bonus, not being a payment for coal actually mined, depletion on such bonus is herein denied (R., p. 49). That makes the present case identical with the *Murphy Oil* case in which certiorari has been allowed.

Respondent makes no answer to the res adjudicata issue.

Upon the *res adjudicata* issue respondent (Opposition, pp. 16-17) merely reiterates the Court of Appeals' reasoning (Petitioners' Brief, pp. 28, 29) which petitioner has fully discussed in its supporting brief (Petitioners' Brief, pp. 30-35). No reexamination of the assertions is necessary under these circumstances.

Conclusion.

Petitioners respectfully represent they are informed the custom of this Court is to grant certiorari when it appears certiorari has been granted and is pending in similar cases, as is here apparent.

For this, and the reasons originally stated in their petition and supporting brief, they respectfully insist the writ should issue herein as prayed in their petition.

Respectfully submitted,

WELLS GOODYKOONTZ,
CAMDEN R. McATEE,
Attorneys for Petitioners.